Nos. 22634, 22634-A

In The
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

ESTATE OF JOHN F. NUTT, Deceased,
Eileen M. Nutt and Frances D. Nutt,
Executrixes, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

EILEEN M. NUTT, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

Before responding specifically to each of the Commissioner's arguments, petitioners again ask the Court to keep in mind that these are two separate appeals by two separate taxpayers who filed two separate suits in the Tax Court after having received two separate notices of deficiency based on two separate income tax returns. In short, the cases here do not involve the determination of the tax liability of a separate tax entity known as the marital community but

the tax liability of two separate taxpayers each of whom is entitled to a determination of whether, assuming the stock in Rancho was owned as community property, he or she retained a right to reacquire the land sold to Rancho.

I

The Commissioner Has Failed To Reply To The Points That He Had Contravened Commissioner v. Brown, 380 U.S. 563 (1965) And Failed To Carry His Burden Of Proof.

At pages 30 through 34 of their opening brief, the petitioners argued that the effect of the Commissioner's regulation 1.1231-1(f) is to apply a restricted definition to the word "sale"[1] which violates the holding of Commissioner v. Brown, 380 U.S. 563 (1965). That case held that the word "sale" as used in the Internal Revenue Code is to be interpreted in its ordinary meaning as a transfer of property for a fixed price in money. Petitioners find no answer in the Commissioner's brief to the said contention.

Also, at pages 10 and 11 of their opening brief, petitioners contended that having departed from the ground relied on in the notices of deficiency, the Commissioner had the burden of proving that each petitioner had retained the right to reacquire his or her interest in the community land and crops which were sold to Rancho, and that the Commissioner

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1. That the regulation attempts to define a "sale" is shown by Judge Chambers statement in the first opinion herein, 351 F.2d 452, that: "We think the regulation really defines what is a substantial sale."

has failed to carry that burden with respect to either of the petitioners and particulaly with respect to Eileen M. Nutt. Petitioners have been unable to find the Commissioner's response thereto.

II

The Commissioner Has Conceded That Assuming Arguendo That The Stock Is Community Property, Eileen M. Nutt Cannot Deal With The Community Interest Registered In Her Husband's Name And Therefore She Cannot Cause All Of The Stock To Be Voted According To Her Wishes And Thereby Reacquire The Land.

In the opening brief the Court's attention was directed by Eileen M. Nutt to the fact that she and her husband are two separate taxpayers each of whom is entitled to a ruling as to whether he or she had a right to reacquire the land sold to Rancho. The importance thereof is that when it is found that John Nutt, as manager of the community, can vote the shares in the name of Eileen M. Nutt and thereby has a right to reacquire the land, it is at the same time being found that Eileen M. Nutt has no such right. The Commissioner has found no way out of this dilemma. Instead, he says:

> "Immediately after the transfer of the property to Rancho, Mr. Nutt could have directed the corporation, through his absolute voting control, to distribute the property to or for the benefit of the marriage community. Since Mr. Nutt had control of all voting stock of Rancho, and

complete dominion over it, he thus retained the right to reacquire, directly or indirectly, on behalf of the marriage community, the land and growing crops transferred to Rancho within the meaning of Section 1.1231-1(f) of the Treasury Regulations. Mrs. Nutt retained the same right through the powers, rights and duties she granted to her husband as the managing member of the marital community." (Respondent's Brief at 29). (Underscoring supplied).

In other words, Mrs. Nutt has the right to reacquire the land because her husband had complete dominion over the stock. Or to put it another way, Mr. Nutt has the right to reacquire the land because he, as the manager of the community, has "complete dominion" over the stock in Mrs. Nutt's name, and at the same time Mrs. Nutt has "retained" the same right to reacquire the land because of the power which she has given to her husband. But how does one retain a right while at the same time giving it away? And how does one have "complete dominion" over another person's stock, based on a position as manager of the community, while at the same time the "managee" retains the same right to vote the stock and reacquire the land?

Eugene Orwell was wrong. It is not going to happen in 1984 but in 1968. Why? Because the conditions Orwell described are here if Mr. Nutt's "complete dominion" over Mrs. Nutt's stock is based on his position as manager of the marital community,

and yet Mrs. Nutt also retains the right to reacquire the land because Mr. Nutt has the power to do so. Does Mrs. Nutt have the power or right to reacquire the land if Mr. Nutt chooses not to exercise his power? Is power or right based on getting someone else's permission before it can be exercised? Would the Court hold that Mr. Nutt had the power and right to reacquire the land if he has to obtain Mrs. Nutt's permission to vote the stock? If not, how can Mrs. Nutt have such a power or right when the very basis of the Tax Court's finding with respect to John Nutt is that it is he, as manager of the marital community, who has the power to vote the shares in her name whether she likes it or not.

The fact is that if Mr. Nutt obtains "complete dominion" over the stock in Mrs. Nutt's name because of his position as manager of the marital community, then Mrs. Nutt cannot have complete dominion over either the stock in her own name or in John Nutt's name. It is ludicrous to conclude that Mrs. Nutt retains the very right which is the basis of Mr. Nutt's "complete dominion."

The effort of the Commissioner to blur and obfuscate this important distinction by referring to the reacquisition of the land by the marital community should be rejected. That begs the very issue which the opinion of Judge Chambers raised in the first appeal herein. What was the point of remanding the case to find out how the stock was owned "and what were the incidents of such ownership" if the two taxpayers were being treated as a unit rather than two separate taxpayers?

A Finding That Each Petitioner Had A Right To Reacquire The Land Is A Finding That There Was No Sale And Hence Neither Of The Two Petitioners Realized Any Gain Upon Which The Commissioner Can Assert A Valid Deficiency.

This Court's first opinion focused attention on the fact that the Treasury Regulation relied on by the Commissioner actually attempts to define what is a "sale", and it must therefore follow that a finding that one has the right to reacquire the land is a finding that there was no sale. The opinion of this Court stated: "We think the regulation really defines what is a substantial sale." The petitioners agree that such is the effect of the regulation. Thus, when the Tax Court found that each petitioner retained a right to reacquire the land, it was holding that there had been no sale. Thus, neither of the petitioners could have realized gain, and the deficiencies asserted herein against them are invalid. The deficiency on the ground that there was no substantial sale should have been asserted against the corporation to whom the land and crops were transferred.

IV

The Commissioner Has Not Successfully Answered Petitioners' Contention That The Tax Court Erred In Holding That The Stock Owned By Each In Rancho Was Community Property Under The Control Of The Husband Who Thereby Had The Right To Reacquire The Land.

The record is clear that each petitioner could not reacquire the land transferred to Rancho. Furthermore, it is simply wrong for the statement to be made that the legislative

intention with respect to Section 1231 (b) (4) was that the section would not apply to farmers except those who were getting out of the farming business as a result of the sale. It is inconceivable that an American Congress, dedicated to the virtues and joys of rural life, would ever dream of writing into the law a plan to drive American farmers out of farming. Surely the government advocate who makes such an argument is viewing the Congress through the eyes of one raised in an urban or metropolitan area which therefore disqualifies him or her from reading the minds of those Congressional committee chairmen who dominate and rule the Congress.

However, assuming arguendo that the Commissioner's vision of the truth with respect to what Congressmen intend was the correct one, the fact is that John and Eileen Nutt were found by the Tax Court to have removed themselves from the farming business. The Tax Court held the corporation which conducted the farming enterprise (Rancho) was not a sham and that it was not to be disregarded for federal income tax purposes. Furthermore, Mr. Nutt and also Mrs. Nutt were merely employees and officers and shareholders of the "farmer" Rancho. Thus, both Mr. Nutt and Mrs. Nutt did get out of farming.

Since the Commissioner has no case at all unless he can carry his burden of proving that the stock in the name of Eileen M. Nutt was community property and that John Nutt had the right to vote that stock as he pleased, the question of whether said stock was community property is dispositive of this case. What has the Commissioner argued with respect

to the issue of whether the stock was community property?

In support of his position, the Commissioner has cited numerous cases at pages 22 through 24 of his brief, the substance of which is that property acquired during marriage is community property and that said property and its fruit retain its character, that the character of property is fixed at the time of acquisition unless altered by agreement of the parties or by operation of law. Petitioners acknowledge that as a general statement of law the statement is correct. However, it begs the point made by petitioners that here the parties did in fact have an agreement evidenced by their actions and intentions at the time the stock was issued. Thus, the controlling case on this point is Jones v. Rigdon, 32 Ariz. 286, 257 Pac. 639 (1927). That case involves facts very similar to those herein. There, the Arizona Supreme Court concluded that the husband caused or permitted a conveyance to be made to his wife. The Court said:

> "The fact that a husband causes or permits a a conveyance to be made to his wife tends to show that it was the intention of the parties that the property should be her separate estate ... even where it appears that the property was paid for with community funds. Contemporaneous conduct by the husband indicating his intention that his wife should have the property, coupled with the fact that the conveyance to the wife is generally held conclusive that the property was intended to be

her separate estate." (Underscoring supplied)

The Commissioner's response to the above case and language is what?

He says the case should be distinquished on the ground that in Jones v. Rigdon, supra, the facts and the deed showed that the husband intended to make a gift to his wife. Of what? Her own one-half of the community? However, assuming that is a valid distinction, the only conclusion consistent with all of the circumstances herein surrounding the issuance of the stock is that each certificate was to be owned individually and separately by each according to the name on the stock registry of the corporation and the stock certificate. Both John and Eileen Nutt participated in the issuance of the separate stock certificates, saw to it as corporate officers that the stock was recorded in the stock register of the corporation in the separate names of each, and in general clearly indicated their intention that the stock be the separate property of each. Under these circumstances the controlling case is Jones v. Rigdon, supra, which holds that it is generally held conclusive that the property is the separate estate of the person in whose name it is held.

Therefore, the cases cited by the Commissioner which say that but for an agreement between husband and wife, property acquired during coverture is community property, and that but for an intervening agreement the property retains that character, are not relevant here. The reason is that the

record here shows that the Nutts agreed and intended that the stock issued in each's name was the separate property of each.

Once the Court reaches the conclusion that Jones v. Rigdon, supra, applies, assuming that it does, then the Commissioner's case is gone.

V

Assuming Arguendo That The Stock In Eileen M. Nutt's Name Was Community Property, The Commissioner's Case Fails Because It Is Not Correct That Under Arizona Law The Husband Can Manage The Marital Community In Such A Way That He Can Vote The Stock In The Name Of Eileen M. Nutt In Such A Way As To Reacquire The Land Whether Or Not She Wishes Him To Do So.

If the stock held in the name of Eileen M. Nutt had been community property, John Nutt could still not have reacquired the land without the consent of Eileen M. Nutt.

Personal property in the form of stock is to be treated differently than personal property generally in terms of the husband's managerial powers. Therefore, the cases submitted by the Commissioner at page 26 of his brief are not material and relevant since they are all concerned with personalty generally and not with stock specifically.

Under the terms of Section 10-231 of the Arizona Revised Statutes it is provided:

"A. Title to a certificate and to the shares represented thereby can be transferred only:

1. By delivery of the certificate endorsed either

in blank or to a specified person by the person appearing by the certificate to be the owner of the shares represented thereby.

2. By delivery of the certificate and a separate document containing a written assignment of the certificate or a power of attorney to sell, assign or transfer the certificate or the shares represented thereby, signed by the person appearing by the certificate to be the owner of the shares represented thereby. Such assignment or power of attorney may be either in blank or to a specified person." (Underscoring supplied)

The Commissioner's response to the above statute is that it is all true but that the force of the statute is negated where the corporation has notice of conflicting claims as where community property laws allow transfer only by the husband though his wife is the named owner of the stock. Here again the Commissioner begs the issue of whether the corporation in fact had notice of any such conflicting claim assuming his basis for a distinction is a valid one. As the Commissioner suggests the corporation knew only what its shareholders, officers and directors knew. Thus, in this case where the two parties took the stock under circumstances evidencing an intention that it be held as separate property of each, the corporation would have no notice of a conflicting claim based on the proposition that the stock in the name of each was actually community property. Quite the opposite was true. The

Contrary to the Commissioner's position at pages 29 through 33 of his brief, a conflict exists between the general community property laws of Arizona which give the husband managerial rights over community personal property and the provisions of Sections 10-231 and 10-233 of Arizona Revised Statutes which indicate that stock issued in the wife's name is controlled by her alone. However, as stated above, Section 25.211 B of Arizona Revised Statutes provides:

> "During coverture personal property may be disposed of by the husband only." (Underscoring supplied)

The above language predates Sections 10-231 and 10-233 of Arizona Revised Statutes which provide that the stock in the wife's name can be transferred and controlled by her only. Under such circumstances of conflict, the Arizona Legislature has provided in Section 1-245 that:

> "When a statute or law has been enacted and has become law, no other statute or law is continued in force because it is consistent with the statute enacted, but in all cases provided for by the subsequent statute, the statute laws and rules theretofore in force whether consistent or not with the provisions of the subsequent statute, unless expressly continued in force by it, shall be deemed repealed and abrogated." Section 1-245, A.R.S.

Thus, what is involved here is a case obviously covered by Section 1-245 even though the Commissioner argues there is a conflict. There cannot be a conflict under Arizona law with

respect to the exclusive right of the wife to control, vote and dispose of stock registered in her name because under Section 1-245 of Arizona Revised Statutes, Sections 10-231 and 10-233 of Arizona Revised Statutes govern - being later in time - over Section 25.211 B of Arizona Revised Statutes insofar as the latter provides that only the husband can dispose of stock. The latter section has been abrogated with respect to stock. The same result was reached in City of Bisbee v. Cochise County, supra.

Therefore, in the instant case, stock held in the name of Eileen M. Nutt, whether community property or not, is to be controlled only by her. The law stated in Section 25-211 B of Arizona Revised Statutes has been changed to provide that: "During coverture, personal property may be disposed of by the husband only, except for corporate stock issued in the name of the wife." This being the case, John F. Nutt could not control the stock in the name of Eileen M. Nutt in such a way as to reacquire the land and crops transferred to the corporation.

With respect to the Commissioner's argument that the purpose of the Uniform Stock Transfer Act is "not primarily to determine ownership but to make uniform in the states the method of transferring title, petitioners reply is that assuming arguendo that such a statement is correct, what of it. The fact remains that the language of the section involved gives only the wife the right to control and dispose of the stock in her name.

At page 31 of his brief the Commissioner says that a reasonable interpretation ought to be given to statutes which would render them valid and operative. Yet petitioners interpretation of the statutes involved herein is the only one which gives effect to the Commissioner's suggestion. The Commissioner's view, on the other hand, negates and renders inoperative the effect of Sections 10-231 and 10-233 of Arizona Revised Statutes. Furthermore, the Commissioner is wrong in saying Mrs. Nutt could not warrant under Section 10-241 Arizona Revised Statutes that she had the legal right to transfer the stock. Why? Because Section 10-231 of Arizona Revised Statutes gives her that right.

The Commissioner's citation of Warren v. Warren, 2 Ariz. App 206, 407 P.2d 395, at page 32 of his brief, is wrong because in that case there is no finding of agreement or intention of the parties that the stock plan should be separate property. Also, the case had nothing to do with the question of whether a husband can transfer to himself and then vote community stock registered in his wife's name.

VI

The Commissioner Has Not Shown That The Tax Court Did Not Err By Abusing Its Discretion When It Denied Taxpayers' Motion To Reopen To Receive Newly Discovered Evidence.

The ruling of the Supreme Court in Commissioner v. Estate of Bosch, 387 U.S. 456 (1967) dictates not that the Tax Court, after receiving evidence of the subordinate state

court decision, must follow the other court's decision but that the Tax Court must give proper regard to that decision. Here the Tax Court, in its almost unseemly haste to affirm its earlier decision against taxpayers, did not even want to consider the state court decision. The Commissioner's argument with respect thereto is an intriquing one. He says the Tax Court was correct because the state court proceeding was non-adversary, and because the evidence which the petitioners sought to introduce was non-persuasive. However, the Bosch case presented the Supreme Court with the question of whether the Tax Court must give attention to non-adversary proceedings in the state court. The Supreme Court held that while the Tax Court or any other federal court is not bound by the state court's adjudication, it cannot ignore the decision and must give "proper regard" thereto even though the proceedings are non-adversary. What the Supreme Court has expressly forbidden, the Tax Court has specifically done in this case. Worse yet it did it after the holding and import of the Bosch case, supra, was fully presented to it, and a plea made that such a step would go a long way toward avoiding an unnecessary remand.

And whether the evidence is non-persuasive or not is not the issue, particularly when the evidence sought to be introduced was a ruling by the state court that the stock issued by Rancho in the name of John F. Nutt was his separate property.

Therefore, for the Tax Court to have made its

decision herein without the offered evidence was another instance of error.

VII

The Taxpayers Are Not Consuming The Court's Time By Rearguing The Issue Of Capital Gain Treatment On The Sale Of Leaseholds To Black Land Farms.

That this Court has the power to change its mind now with respect to the sale of leaseholds issue is too clear to require authority. The petitioners do not and did not intend the waste the Court's time rearguing the issue, but merely advanced the point so that it cannot later be said by the Commissioner that they abandoned the issue. The petitioners do not think it unreasonable to believe that this Court, unlike the Tax Court, would change its mind on an issue upon further reflection and further research.

CONCLUSION

Each petitioner submits that the Tax Court should be reversed.

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

William A. Harrell

William A. Harrell

Dated: August 7, 1968

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Dated: August 7, 1968